



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Number: **201002040**
Release Date: 1/15/2010

Date: October 20, 2009

UIL: 501.10-00

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:
1120

Tax Years:

Dear _____:

This is our final determination that you do not qualify for exemption from Federal income tax under Internal Revenue Code section 501(a) as an organization described in Code section 501(c)(10).

We made this determination for the following reason(s):

You are not operated for fraternal purposes; You are not operated under the lodge system; and You do not devote your net earnings to exclusively charitable or fraternal purposes.

You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at

1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Robert Choi
Director, Exempt Organizations
Rulings & Agreements

Enclosure
Notice 437
Redacted Proposed Adverse Determination Letter
Redacted Final Adverse Determination Letter



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Date: September 10, 2009

UIL 501.10-00

Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

Legend:

Fraternal =

Parent =

A =

B =

X =

Xy =

Xvy =

Charter fee =

Date =

Dear :

We have considered your application for recognition of exemption from Federal income tax under Internal Revenue Code section 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under Code section 501(c)(10). The basis for our conclusion is set forth below.

FACTS:

You were incorporated in 2004, under the laws of the state in which you are located. Your Articles of Incorporation (charter) states that you are organized exclusively for charitable and fraternal purposes, including, for such purposes, the making of contributions to organizations that qualify as exempt organizations under section 501(c)(3) of the Internal Revenue Code, or corresponding section of any future Federal Tax Code.

Article 6 of your charter states that you are organized to provide a private club for your members for social, fraternal, and community purposes and all other lawful purposes. You claim to be affiliated with Fraternal and Article I of your bylaws states that you are a subordinate under Parent.

Article II of your bylaws states that your objectives are:

1. To promote the social and moral welfare of your members;

2. To encourage human and spiritual values of life;
3. To cooperate in all charitable and civic appeals;
4. To provide a practical means to form meaningful friendships, altruistic services, and to build better communities;
5. To promote true patriotism to our Country and to be a loyal Fraternal;
6. To cooperate in creating and maintaining sound public opinion and high standards which make possible the promotion of goodwill and community concern for others; and
7. To promote education for your members, their family, and for the community.

Your narrative description of your activities and operations states that you plan to operate a social club where members can meet for socializing, dining, and entertainment. You state that entertainment will include music, card games, chess, video games, dancing, and billiards. These activities will be available on a daily basis Monday through Saturday from 11:00 a.m. to 12:00 midnight and on Sunday from 1:00 p.m. to 12:00 midnight. You state that socializing, dining, and entertainment will be your primary daily activities. Your application states that these activities will further your exempt purposes by encouraging members and their guests to buy food and beverages which are income producing activities that aid in your ability to donate to charities and the community.

In further describing your activities you state that you may sponsor annual holiday parties for children of the community. You state that at each of these events food will be served and food and clothing may be provided for needy children. You will also promote activities that benefit the moral, education, and welfare of your members and their communities.

You state that you will hold organizational meetings on a monthly basis. Your application states that your activities will generally be held at your facilities and all activities will be conducted by your members. You state there will be no fees charged to participate in your activities with the exception of annual membership dues of twenty-dollars (\$20.00).

Article VI of your bylaws states that applicants for membership shall be any person not less than twenty-one (21) years of age and of good moral character. Applications for membership must be received in writing, signed by the applicant and by a member of Fraternal in good standing who recommends the applicant and gives the applicant's name, age, residence, occupation, and such other information as the chartered club may prescribe. On March 19, 2006 you stated in response to an IRS letter seeking further information, that "effective in the near future, all individuals entering the premises will be members." Each member will pay their dues on a quarterly basis and obtain membership cards to gain access to the premises." Prior to this time anyone could enter your facility whether or not they were members to engage in your social and entertainment activities.

Your application states that you operate under the lodge system and your parent organization is Parent. You state that dues are paid quarterly to Parent who operates for the benefit of its subordinates. There are no classes of persons required to join. Members have the right to use all of your facilities and have full voting privileges.

On March 14, 2006 in response to an IRS letter asking for a further description of how you planned to achieve your objectives, you responded that you will specifically focus your charitable efforts on local schools and local sports organizations. In addition to regular donations, you state that you will host at least two (2) public events per year for charitable purposes. You state that these events will possibly include an evening meal event and a sports tournament.

On May 19, 2006 in response to another IRS letter requesting additional information regarding your activities and operations, you state that "no member of the organization's governing body will have a business relationship with the organization." In your reply to the October 19, 2005 correspondence, you state that A is your president and also president of B. Additional correspondence from you to the IRS regarding your exemption application states that B is your landlord and A, your president, is now sole owner of B. You state that leasehold improvements have been made to the property that you lease from B. Such improvements include expansion of the building and the sidewalk and parking lot addition. While there is controversy as to who paid for these improvements, you represent that B paid for the improvements in the amount of x and that you did not pay for the improvements nor are expected to reimburse B for making the improvements. Also, despite your having stated that "no member of the organization's governing body will have a business relationship with the organization," you state in your reply to the IRS letter dated April 17, 2006 that you presently have two outstanding loans payable to A and B. These loans include Xy payable to A, your president, as start-up capital for your organization, and Xyy payable to B as initial capital for all facility equipment, initial legal fees, and the Charter fee paid by you to Parent. You state that due to current financial conditions payments are not being made on these loans from A and B. You state that these loans were made as verbal agreements—no written documentation exists and when payments are made the monthly amounts will be at an interest rate of six percent (6%).

You have video lottery machines on your premises. You pay Parent 1% of the lottery machine income quarterly and also pay Parent \$5.00 per member per quarter. Finally, in support of your application, you have made the following assertions:

- A. Effective Date all individuals entering the premises must be active members of your organization;
- B. Effective Date members must show their membership cards to gain entry;
- C. Effective Date the members of the Board of Directors will review bi-monthly the meeting attendance and participation in your activities by each member. Should the Board determine that any member is not active, the Board will first issue a warning letter to said member. If said member remains inactive, the Board will recommend their membership termination;
- D. Effective Date you will place a suggestion box on the premises for members to voice their opinions as to donations and activities;
- E. Effective Date you will hold informal member social hours, at least three (3) times per week, and keep informal minutes of said social hours. The purpose of these sessions is for members to socialize and offer suggestions as to donations and activities;
- F. Effective Date a membership log will indicate all individuals entering the premises, to include the date and signature. This log will be used by the Directors when reviewing the active participation of members.

LAW:

Section 501(c)(8) of the Internal Revenue Code (the Code) provides for the exemption of fraternal beneficiary societies, orders, or associations operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents.

Section 501(c)(10) of the Code provides for the exemption from federal income tax of domestic

fraternal societies, orders, or associations operating under the lodge system, the net earnings of which are devoted exclusively to religious, charitable, scientific, literary, educational, and fraternal purposes, and which do not provide for the payment of life, sick, accident, or other benefits.

Section 1.501(c)(10)-1 of the Income Tax Regulations (the regulations) provides that an organization will qualify for exemption under section 501(c)(10) of the Code if it is a domestic fraternal beneficiary society, order, or association, described in section 501(c)(8) and the regulations thereunder, except that it does not provide for the payment of life, sick, accident, or other benefits to its members, and devotes its net earnings exclusively to religious, charitable, scientific, literary, educational, and fraternal purposes.

The leading judicial pronouncement as to what constitutes a "fraternal beneficiary society" is contained in the following extract from National Union v. Marlow, 374 F. 775, 778 (1896):

"... a fraternal-beneficial society ... would be one whose members have adopted the same, or a very similar calling, avocation, or profession or who are working in union to accomplish some worthy object, and who for that reason have banded themselves together as an association or society to aid and assist one another, and to promote the common cause. The term "fraternal" can properly be applied to such an association, for the reason that the pursuit of a common object, calling or profession usually has a tendency to create a brotherly feeling among those who are thus engaged.... Many of these associations make a practice of assisting their sick and disabled members and of extending substantial aid to the families of deceased members. Their work is at the same time of a beneficial and fraternal character, because they aim to improve the condition of a class of persons who are engaged in a common pursuit and to unite them by a stronger bond of sympathy and interest...."

The National Union did not fit this definition, because it was an association of individuals who were associated for the purpose of obtaining insurance. The court concluded that:

In its practical operations, therefore, the defendant company cultivates fraternity and confers benefits in the same manner that every insurance company doing business on the mutual plan cultivates feelings of fraternity, and confers benefits upon its members. Or, in other words, when the defendant is stripped of all disguises, and judged by the standard of what it is engaged in doing, and what it was most likely organized to do, it is simply an insurance company which carries on an extensive business on the assessment plan.

Central to the concept of fraternal beneficiary societies, whether described in section 501(c)(8) or 501(c)(10) of the Code is the requirement of a fraternal element, a common bond among members. The requirement of a fraternal element is set forth in Philadelphia and Reading Relief Association, 4 B.T.A. 713 (1926).

In that case, an organization composed of railroad employees organized to administer a relief fund for the payment of benefits to its members in case of sickness, accident or death, fell short of this requirement because it lacked the required fraternalistic element. The court noted that the association's membership consisted of individuals whose vocations were as numerous and diverse as the classifications of jobs of a railroad company; that the only motive for the

existence of the association was a mercenary one (to provide insurance benefits); that the organization did not have "rituals, ceremonial, and regalia" commonly associated with fraternal associations; and that it was not operated on the lodge system.

In another case, the U.S. Tax Court held that an organization cannot be classified as fraternal when the only common bond between the majority of its members is their membership in that organization. Polish Army Veterans Post 147, 24 T.C. 891 (1955), affirmed as to nonexempt status, 236 F.2d 509 (1956). Only 10 percent of the members had common ties in that they were Polish war veterans or children of such veterans who had served in the armed forces of the Western Alliance. All other dues-paying members were admitted indiscriminately as long as they were elected to membership by a majority vote of members present at any meeting.

The question as to the meaning of "fraternal" was also explored in Wheeler v. Ben Hur Life Ass'n, 264 S.W.2d 289 (1953). The court concluded that the organization was not fraternal.

. . . The association's constitution and by-laws duly provide for a lodge system, ritualistic form of work, and representative form of government. It has no capital stock and is ostensibly organized solely for the mutual benefit of its members. But actually, while giving superficial attention to these requirements, the Association has been engaged in the life insurance business. The local agent of the Association draws a salary and receives as a commission 50% of the first premium on all insurance policies. He receives a smaller percentage of subsequent premiums . . . The Association's constitution and by-laws provisions relative to ritualistic work are observed only perfunctorily . . . We are convinced from the evidence in this record that the primary function of the Ben Hur Life Association is to sell insurance, and that the Association actually is an insurance company operating under the guise of a fraternal benefit society.

To qualify for recognition of exemption as a fraternal beneficiary organization under section 501(c)(8) or section 501(c)(10) of the Code, an organization must also be operated under the lodge system. Section 1.501(c)(8)-1 of the regulations states that operating under the lodge system means "carrying on its activities under a form of organization that comprises local branches, chartered by a parent organization and largely self-governing, called lodges, chapters, or the like." At a minimum, this requires separate subordinate lodges that operate under the general control and supervision of a parent lodge, and are subject to the laws and edicts of the parent lodge.

In Western Funeral Benefit Association v. Hellmich, 2 F.2d 367, 369 (1924), the District Court for the Eastern District of Missouri defined "lodge system" as follows:

By the "lodge system" is generally understood an organization which holds regular meetings at a designated place, adopts a representative form of government, and performs its work according to a ritual. That does not seem to be a harsh definition of what is usually understood as the lodge system and is not so strict in its requirements as the definitions often stated in the statute books.

Rev. Rul. 73-165, 1973-1 C.B. 224 concerns an organization that was operated under the lodge system, was engaged in conducting fraternal activities, but whose predominant activity was the provision of benefits to its members. The ruling concludes that the organization was described in section 501(c)(8) because there is no requirement that either the fraternal or the insurance features predominate so long as both are present. The ruling is clear, however, that in order for

an organization to be described in section 501(c)(8) it must contain substantial fraternal features and conduct substantial fraternal activities. The courts have described fraternal activities as a grouping together of like-minded individuals to accomplish a common purpose. The group must be bound by more than membership in the organization and motivated by purposes other than solely the provision of insurance benefits.

Rev. Rul. 77-258, 1977-2 C.B. 195, provides that a domestic fraternal society operating under the lodge system, which does not provide life, sick, accident, or other benefits, whose members are interested in the use of and philosophy behind a method of attempting to divine the future, and whose net income is used to provide instruction on the use of the method, maintain a reference library, and supply information on the method to the public, qualifies for exemption under section 501(c)(10) of the Code.

RATIONALE:

The information you provided fails to establish that you are a domestic fraternal society, order, or association that qualifies for exemption from federal income tax under section 501(c)(10) of the Code. You are not operated for fraternal purposes; you are not operated under the lodge system; and you do not devote your net earnings to exclusively charitable or fraternal purposes.

Fraternal Purposes:

Although there is no definition of fraternal purpose in the Internal Revenue Code, we presume that Congress used the term in the ordinary sense, and according to its legal significance in 1909 when section 501(c)(8) was added. The courts in the cases cited above, were clear in requiring at a minimum that the members of a fraternal organization have a common tie that is more substantial than the desire to purchase insurance or engage in social activities. "....a fraternal-beneficiary society...would be one whose members have adopted the same, or a very similar calling, avocation, or profession or who are working in union to accomplish some worthy object, and who for that reason have banded themselves together as an association or society to aid and assist one another, and to promote the common cause." National Union v. Marlow, supra. "An organization cannot be classed as fraternal where the only common bond between the majority of the members is their membership in that organization." Polish Army Veterans Post 147. Evidence of fraternal activities, such as "rituals, ceremonial, and regalia," helps to establish that an organization has a fraternal purpose. Philadelphia and Reading Relief Association, supra. Rev. Rul. 73-165 echoes Congress and the courts in holding that to establish exemption, a fraternal organization must have substantial fraternal features and conduct substantial fraternal activities. Lastly, we look to substance over form. The fact that an organization's constitution and bylaws may provide for a "lodge system, a ritualistic form of work, and representative form of government" is not enough if actual operations establish a primary function that is not fraternal. Wheeler v. Ben Hur Life Association, supra.

You do not have substantial fraternal features. Your membership is open to anyone over 21 years of age willing to pay a nominal membership fee, similar to a cover charge. Your bylaws do not require and you submitted no evidence to establish that your members have a specific "calling, avocation or profession" or a "common tie." Unlike the organization described in Rev. Rul. 77-258, whose members had a single pursuit, your activities do not illustrate how your members have joined together or worked in unison to accomplish any worthy objective. The only common bond among your members appears to be their membership.

Further, you stated that you have an open guest policy and do not keep a guest log or other

records. You have not established that your members pay for the entertainment of their guests. Without further documentation, we are unable to conclude that you are not open to the general public in the same manner as a commercial tavern.

Nor have you submitted evidence that your listed members have actually participated in substantial fraternal activities. Your operation of a public tavern and conduct of gaming is not inherently a fraternal or a charitable activity. Your charter and bylaws do not provide for rituals, ceremonials, or regalia commonly associated with fraternal associations. You have had a few member meetings but you have not engaged in any member activities in furtherance of your stated objectives. Accordingly, you are not operated for fraternal purposes.

Lodge System:

An organization is "operating under the lodge system" if it operates under the general control and supervision of a parent lodge, and is subject to the laws and edicts of the parent lodge. It is generally understood that such an organization holds regular meetings at a designated place, adopts a representative form of government, and performs its work according to a ritual. The courts look to substance over form. Wheeler v. Ben Hur Life Association, supra. A similar result was reached in Western Funeral Benefit Association v. Hellmich, supra.

We cannot conclude, on the basis of this record, that you are properly chartered and under the general control and supervision of a parent lodge. You submitted a signed affiliation agreement with Parent assigning you a lodge number. Although your stated purposes are identical to that of Parent, you submitted no information regarding Parent's activities or its rules regarding your participation. The agreement is devoid of any operational or oversight requirements regarding your activities.

You are required to pay Parent a substantial chartering fee and a percentage of all gaming revenue to use Parent's name. The only oversight Parent exercises is to audit your financial statements to be sure it is paid the proper amounts. This is similar to the purchase and operation of a commercial franchise.

We also cannot conclude that Parent exercises supervision and control over other independent lodges. This does not satisfy the requirement that a parent control and supervise separate, independent, subordinate lodges that are operating under the lodge system.

Further, you have had only a few membership meetings. Since you are totally controlled by your founders and do not follow your bylaws as to member input, we cannot conclude that you have a representative form of government.

In addition, since you have held only a few member meetings and have not commenced fraternal activities, we cannot conclude that you perform your work according to a ritual. Accordingly, you are not operated under the lodge system.

Devotion of Net Earnings to Exclusively Charitable or Fraternal Purposes:

The information you submitted shows that B paid your chartering fee and all additional expenses associated with your formation. In return, you have contracted with B, an organization wholly owned by A your president, to rent and operate your facility. We conclude, therefore, that your net earnings are used predominately to engage in business undertakings. In addition, we are unable to conclude from the information submitted that your net earnings do

not inure to A in the form of inflated payments for services rendered through his company. Since your net earnings are used predominately to engage in business undertakings that enhance the financial well being of A, we cannot conclude that your net earnings are used exclusively for religious, charitable, scientific, literary, educational, and fraternal purposes as required by section 501(c)(10) of the Code.

CONCLUSION:

You are not described in section 501(c)(10) of the Code because:

- You are not operated for fraternal purposes;
- You are not operated under the lodge system;
- You do not devote your net earnings to exclusively charitable or fraternal purposes.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination.

Your protest statement should be accompanied by the following declaration:

Under penalty of perjury, I declare that I have examined this protest statement, including accompanying documents, and, to the best of my knowledge and belief, the statement contains all the relevant facts, and such facts are true, correct, and complete.

You also have a right to request a conference to discuss your protest. This request should be made when you file your protest statement. An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you. If you want representation during the conference procedures, you must file a proper power of attorney, Form 2848, Power of Attorney and Declaration of Representative, if you have not already done so. For more information about representation, see Publication 947, Practice before the IRS and Power of Attorney. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848 and any supporting documents to this address:

Internal Revenue Service
TE/GE (SE:T:EO:RA:T:3)

1111 Constitution Ave., N.W.
Washington, DC 20224

You may also fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Director, Exempt Organizations
Rulings and Agreements

cc: